

Consumers Energy

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SENATE ENERGY AND TECHNOLOGY COMMITTEE

David Mengebier

Senior Vice President of Governmental & Public Affairs
Chief Compliance Officer

Senate Bill 437

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INTRODUCTION

Good afternoon Chairman Nofs, Vice Chairman Proos, Vice Chairman Hopgood and members of the committee.

My name is David Mengebier. I'm the Senior Vice President of Governmental and Public Affairs and Chief Compliance Officer for Consumers Energy. With me this morning is Tim Sparks, our Vice President of Energy Supply.

Thank you for this opportunity to testify in support of Senate Bill 437.

Let me start off by saying that Consumers Energy recognizes the issue of Michigan's electric market design and planning for future capacity is complex. Therefore, the time you have spent on this subject with workgroup meetings and countless hours of testimony is appreciated.

RESOURCE ADEQUACY

In our view, inaction on energy policy presents significant risks to Michigan and to our business and residential customers. As Valerie Brader stated last week, 25 Michigan generating units have closed or will close by 2020. Seven of these plants are owned and operated by Consumers Energy and will retire in April of 2016. With these closures, data shows the Lower Peninsula of Michigan will see an electric capacity shortfall beginning next year.

A shortfall can lead to decreased reliability and increased price volatility for our customers.

Let me be clear – while the MISO Region shows a surplus, lower Michigan is the only zone where there is a 1,200 MW shortfall in meeting its reserve margin requirements in 2016.

While Michigan can import some electric capacity from other states, MISO rules require the majority of a utility's or alternative electric supplier's capacity to be located in the zone they serve, unless the utility or alternative electric supplier buys all of its capacity from the annual MISO capacity auction. Overreliance on out-of-state energy is not, in our view, a stable nor sustainable long-term policy for Michigan.

This shortfall is not the result of poor planning on our part. Earlier this year, Consumers Energy filed a plan with the MPSC showing we have sufficient supply and demand response programs in place to meet our customers' needs and maintain adequate reserve margins for the next five years.

However, we are not planning for the 800 MW of load that is currently taking electric service from alternative electric suppliers. To put this in perspective, 800 MW is the size of a large power plant which would take about four to five years to site, permit and build. Under current Michigan law, some or all of these ROA customers could return to the utility with as little as 60 days' notice.

If wholesale markets tighten because new generating capacity is not built in time to replace retiring plants, alternative electric suppliers may not be able to secure firm, physical capacity – or they may be unable to meet their obligations because the cost to acquire the capacity becomes too high.

Under MISO's rules, we are the provider of last resort, so we would be required to serve these customers, leading to increased costs and creating potential reliability problems, not just for returning ROA customers, but for all of our customers.

This is not speculation on our part, nor is it a short-term problem. With the expected closure of approximately 70 generating units in the MISO footprint in the next four years, we expect the market to move quickly from a surplus to a shortage of capacity, driving up market prices for power. **In fact, the electricity markets are already showing signs of tightening supply.**

In addition to the reliability and price volatility issues I've outlined, where Michigan gets its generating capacity is an economic development and jobs issue. Importing electricity from other states exports our jobs and turns over control of Michigan's energy future to outside parties.

To mitigate these risks, it is imperative that we get a fair Michigan policy in place this fall to assure all customers have affordable and reliable energy for years to come.

FAIRNESS

The 2008 energy law has largely been a success, but it has a fundamental flaw that raises significant fairness issues for many customers. Since that law was passed, a cost-shifting subsidy paid by traditional utility customers to those served by an alternate electric supplier totals more than \$1 billion.

Clearly, deregulation of electric markets is not the answer. **On almost a daily basis, we read news stories about electric deregulation causing skyrocketing customer bills, raising reliability concerns because plants aren't getting built, and leading regulators to adopt increasingly complicated and high-cost mechanisms that mimic regulated markets.** This is happening in Illinois, Ohio and other higher-cost states that adopted deregulation.

While Consumers Energy believes the best energy policy would be to return to a fully-regulated electric market, rather than continuing with the 10 percent cap, we are supportive of the direction Senate Bill 437 takes to address the current inequities in the law today.

Senate Bill 437 provides for a fair transition toward a more stable regulatory model, levels the playing field and protects customers with these key provisions:

- It requires alternative electric suppliers to secure at least three years of firm, physical capacity. This is only fair; regulated utilities must demonstrate they have adequate resources to meet demand over 15 years.
- SB 437 requires customers to provide three years' notice prior to returning to utility service so that we can adjust our supply and demand response programs accordingly.
- The bill protects full-service customers from bearing costs associated with the return of ROA customers without adequate notice.
- And it requires fair choice by preventing customers from moving back and forth between regulation and deregulation, reducing the cost shifting to bundled residential and small-business customers.

An underlying theme in the legislation is one of fairness. If customers were granted certain rights under the 2008 law, the chairman and his staff have been careful not to take those rights away. This should not mean, however, that these provisions should be exploited to expand the cap.

Under our reading, the current draft has a number of provisions that appear to move the state in the wrong direction. These include:

- The ROA queue or "wait list" should be eliminated because it simply perpetuates the current partially deregulated hybrid framework and the potential for continued unfair cost shifting onto full service customers.
 - If the queue is retained in the new law, current law should be reinstated requiring sufficient head room under the 10 percent cap to accommodate the next customer in line's entire load before they can move to ROA.
- The 10 percent deregulation cap should be a hard cap. With the grandfather provision provided in 2008, the current cap is already at 10.5 percent. Further leakage or expansions of the cap should not be permitted.
 - Expansions of the 10 percent cap or special carve outs for a select group of customers only exacerbates the unfair shifting of fixed costs onto customers taking full utility service.
- The three-year firm physical capacity requirement should be expanded to five years. The current bill has a somewhat complicated mechanism that ties the capacity requirement to a MISO determination that a shortfall exists.
 - We are concerned that if we reach this stage, it may be too late and we will not have the four year lead time to build a plant. We recommend that the committee simplify this process and require alternative electric suppliers to secure five years of capacity.

ADAPTABLE AND CLEAN

The energy industry has been undergoing a period of rapid change over the past decade, and we expect the future will bring more changes. For example:

- The shale revolution in America has led to lower gasoline prices at the pump, but it also fundamentally changed the economics of natural gas, giving us access to an abundant, low-cost, clean and reliable fuel source for electricity production.
- Renewable energy costs have also gone down dramatically in recent years. There's no doubt renewable energy will be an important and increasingly affordable part of our future electricity portfolio going forward.
- At the same time, we're seeing federal policy changes that will significantly impact the energy sector. Tax credits for renewable energy systems are expiring – leading to debates in Congress about extensions, and major new environmental rules are coming into effect. There's been a lot of discussion about the Clean Power Plan recently. Getting less attention is the fact that the EPA is also about to finalize a new standard on ozone that could put many Michigan counties in non-attainment and have dramatic impacts on Michigan's ability to build or expand power plants and manufacturing facilities in the coming years.
 - These environmental rules have major implications for our supply portfolio, causing more coal plants to shut down in the future.
- Wholesale energy markets are likely to see greater price volatility as we enter periods of capacity shortfalls.

All of this rapid change means Michigan needs to have an adaptable energy policy that will drive smart investments not only in baseload plants, but in clean energy and energy waste reduction. We believe the Integrated Resource Planning (IRP) process created by SB 437 accomplishes just that. It provides an open and fair process by which Michigan can make smart decisions about our energy future – balancing reliability and affordability and ensuring we comply with all federal environmental rules.

If circumstances change, which is likely, the IRP process provides the flexibility for our state to adapt. At the same time, the process is transparent and open to all stakeholders who might have good ideas about how we should meet electricity demand.

The IRP builds off of the already successful Certificate of Need process (CON) established in 2008. This process benefitted Consumer Energy's customers when we made the decision to buy an existing efficient combined-cycle natural gas plant in Jackson for about one-quarter the cost of building the plant we had proposed in Genesee County.

The IRP broadens the inclusion of other forms of generation planning options such as transmission, renewable energy, demand response and energy waste reduction. In contrast, the current CON process is limited to major generation projects and long-term power purchase agreements that exceed \$500 million. Renewable energy projects and environmental upgrades are specifically excluded from the CON process today.

Although the proposed IRP process makes significant changes to the way we do generation planning today and presents some uncertainties, we are open to its more up-front transparent and inclusive approach and believe the IRP framework is critical to a Michigan-First energy plan.

On one point, I want to be very clear: we will oppose any requirement that would effectively force utilities to sign long-term contracts with third party power plants. The IRP process gives all interested stakeholders an opportunity to advance alternative proposals and establishes a very stringent legal standard of MPSC review.

In our experience, long-term contracts lack flexibility, locking in prices for customers to a sole source of supply for decades and greatly restricting our operating flexibility in the face of changing market conditions.

In sharp contrast, a utility with a diverse set of power plants can adjust the operations of its generating resources, flexibly ramp them up or down to adapt to changing circumstances, saving customers money. Customers also benefit from lowest-cost power plants when they are depreciated, a reduction in costs that does not occur with long-term power purchase agreements.

We will proactively enter into long-term contracts with third parties when they keep our business rates competitive and residential bills affordable. Just yesterday, we announced we will be purchasing the power from a new 100 MW wind farm in Huron County that is owned and operated by a third party.

We are proud of this investment in a renewable energy project that takes us beyond the current 10 percent renewable energy requirement. Importantly, it demonstrates that **we don't need mandates to make investments in wind, solar and other clean energy projects** when they make sense for our customers.

Likewise, we also plan to continue investments in energy waste reduction programs. However, it is imperative that the right regulatory framework be in place, including an incentive or benefits sharing program with customers, and a true-up mechanism such as decoupling. We are supportive of energy waste reduction programs if we have a regulatory environment that is beneficial to both our customers and our shareowners.

AFFORDABILITY AND ECONOMIC DEVELOPMENT

I'd like to close with some brief comments about the inter-relationship between a sound, Michigan-First energy policy and economic development. **As a hometown utility, we are proud of the part we play to support Michigan's economy.** We are also proud partners with state and regional economic development organizations working together to retain, attract and expand new jobs and growth in Michigan.

Under the Pure Michigan Business Connect program, for example, we continue to increase our spending with Michigan-based suppliers and vendors. Since its inception in 2011, Consumers Energy has increased spending with Michigan companies by \$1 billion, creating more than 5,000 jobs. We recently renewed and increased that commitment to \$1 billion per year over the next five years.

Policies adopted by the Legislature, such as the energy intensive tariff established last year by PA 169, have already reaped major economic benefits in Consumers Energy's service territory:

- Brembo, an Italian brake manufacturer, is locating in Homer and creating several hundred manufacturing jobs.
- Cidic Dycastle, a Chinese aluminum wheel manufacturer, is locating a major factory in Greenville.
- Arauco, a manufacturing company, just announced this week that it will invest \$325 million to build a particleboard mill – the largest in North America – in Grayling.

All three of these companies pointed to the energy intensive tariff established by the Michigan Legislature and approved by the MPSC as a major factor in their decisions to locate and create jobs in our state.

We know one of the major drivers of economic development is rate competitiveness, especially for manufacturing operations, and Consumers Energy has been working hard to bring our business rates down and in line with other Midwestern states.

As noted by Valerie Brader last week, our industrial rates are moving in the right direction. According to EIA data, Michigan's rates for industrial customers have dropped by nearly 10 percent from 2014 to 2015. Consumers Energy's industrial rates in Michigan (7.09 cents per kilowatt hour) are now just above both the Midwest (6.7 cents) and national averages (6.75 cents). In December, our rates for manufacturing customers will be even lower with additional reductions between 3 percent and 7 percent for the manufacturing sector. Energy intensive customers, which use large amounts of energy, will see further reductions.

At the same time, we are helping to keep residential bills affordable. Michigan bills for residential customers (\$96 per month) are below both the Midwest (\$98) and national averages (\$113). I'm pleased to report that both our electric and gas residential customer satisfaction scores, where price is a major driver, are in the first quartile and among the top scores among large Midwest utilities.

CONCLUSION

Thank you for the opportunity to testify this afternoon.

Consumers Energy supports Senate Bill 437 as it incorporates important principles of fairness, adaptability, affordability, and sustainability. We also like the fact that our decisions about Michigan's energy future lie with you, Michigan legislators, and not in the hands of Washington D.C.